

Testimony of

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Before

The Committee on Banking and Financial Services
U.S. House of Representatives

on

Efforts to Combat Money Laundering

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My name is Jack A. Blum, I am a partner in the Washington, D.C. law firm of Lobel, Novins & Lamont. I am here this morning to share with you some of the conclusions and suggestions of the United Nations experts group on money laundering which were presented to the special session of the General Assembly in New York earlier this week.

The experts group included Professor Phil Williams, Director of the Ridgway Center at the University of Pittsburgh, Professor Tom Naylor of McGill University, Professor Michael Levi of the University of Wales at Cardiff, and me. Our study was financed by the United Nations Crime and Drug Control Programme but our conclusions are ours alone and do not reflect the views of the United Nations or of the program's staff.

Rather than repeat the text of the report itself, I will briefly summarize the major points and focus on the issues we believe should be addressed by the international community and by individual governments.

Offshore banking, the use of offshore financial centers and the use of tools which place money beyond the reach of the civil and criminal justice systems has grown exponentially over the last few years. There are now more than one million anonymous corporations and we estimate more than \$5 trillion in assets are held in the name of offshore entities. While a substantial portion of this is legitimate -- businesses such as captive insurers and shipping subsidiaries -- a very substantial portion is not. The portion that is not is the bank for the international criminal community. It is where most of the world's drug money is laundered. It is home to the proceeds of crime from around the world.

The data on money laundering and on the use of offshore financial centers is inadequate. We were forced to make estimates because many of the offshore financial centers do not report their activities in a

useable form or conceal their data by including it in aggregates. Very little information is available on the holdings of International Business Corporations¹ because these corporations are not required to file financial reports. A serious effort should be made to get the offshore financial centers to report the full scope of the activity they support.

Most of the world's money laundering in offshore centers involves tax evasion. Although there are legitimate ways of using offshore entities to minimize taxes, most of the offshore arrangements are designed to avoid income and estate tax by the home country of the owner of the money. Tax evasion should become a predicate offence for the crime of money laundering. All too frequently the professionals who help serious criminals cover their actions by claiming that all they are doing is helping someone "avoid" taxes.

Money laundering is an essential element of international financial fraud, market manipulation, illegal arms dealing, people smuggling, and the theft of intellectual property. Indeed, the amounts concealed in connection with these other crimes far exceed the total amount laundered by the drug trade. The Criminals engaged in all of these activities use the facilities of the offshore financial world to hide their profits, and pay their suppliers and employees.

Money laundering is also an essential component of government corruption. In country after country corrupt heads of state and governments officials have moved tens of billions of dollars into the offshore markets. Presidents Mobutu, Sukarno, Marcos, Duvalier, Bucaram, and Color de Mello are but a few examples of disappearing national wealth. When the money disappears, the IMF and the international community is called upon to replace it. If the money could not be effectively hidden, the problem of corruption could be mitigated.

Money laundering is also supporting the explosive growth in international financial fraud. The advance fee for loan schemes, prime bank frauds and dozens of other sophisticated scams depend on the unregulated offshore financial world.

Efforts to control money laundering have been largely ineffective because of the inadequate judicial cooperation machinery, the willingness of countries to use their laws to protect launderers, and the wide availability of legal forms and structures which help hide money from police inquiry. Even the best run law enforcement operations touch only a small fraction of the money laundering trade. Operation Casablanca - dramatic as it was - barely dented the multi-billion dollar flow of drug funds through Mexico. To control money laundering it is essential to focus on the machinery launderers use and the people who help them use it.

We noted that the basic principle of non-intervention should be applied to the machinery of the offshore financial world. Many of the world's "offshore financial center" jurisdictions have gone into the business of providing non-residents and non-citizens with tools designed to defeat the laws of their home countries. These tools include International Business Corporations, bank secrecy which blocks

inquiries from law enforcement agencies, trust laws which are designed to conceal and protect assets, and unregulated international banks and trust companies. The creation of these tools undermines and degrades the entire international legal system. We consider the action of the countries providing these tools as an intervention in the affairs of their neighbors and, as such, unacceptable.

Bank secrecy has a legitimate function. Bank account information must be protected against intrusions by competitors, criminals seeking to identify targets, and curious private citizens. Each of us wants and need to have our affairs private. However, the "bank secrecy" jurisdictions have created the ironic situation in which the data held by the banks is kept safe from legitimate inquiries by foreign police but may not be safe from electronic intrusion or disclosure to third parties. This has come about because bank data is now available globally in computer networks which support bank card operations and related credit cards. The data may be posted in a secrecy jurisdiction but may wind up in the hands of people with access to the system in a place far beyond the reach of the country offering secrecy. If information is disclosed improperly there may be no effective remedy. The issues surrounding information protection and privacy should be the subject of international agreement if the privacy rights of individuals are to be protected.

We believe that there should be no bank secrecy with respect to legitimate, court approved inquiries relating to criminal matters. The only exceptions to this rule should be in cases of political persecution to protect the human right of the individual.

The International Business Corporation - a corporation with anonymous ownership which can do no business in its country of incorporation - has no legitimate place in the international arena. IBC's are now the central tool of money launderers. These anonymous corporations open bank accounts in bank secrecy countries to hide asset ownership. Originally the corporate form was designed to limit liability. Later it had the effect of separating ownership and management. It was never meant to shield the owners of a corporation from responsibility for their actions. We concluded that, at the very least, the chartering government of a corporation should be able to identify the beneficial owners and hold them accountable for their acts.

A number of jurisdictions have passed trust laws which allow the creation of sophisticated grantor trusts which can be used to hide assets and protect them from foreign judgments. These trust instruments do not identify either the grantors or beneficiaries. The real intent of the trust is hidden in side "letters of wishes" and the real control is in the hands of a "trust protector" who is not identified in the trust instrument. All of this is designed to hide the identity of the beneficial owner. In some countries trusts are not subject to foreign judgments and their validity cannot be challenged after a brief initial period. The trusts are often used in conjunction with IBC's to create an impenetrable maze. We concluded that these trusts do not serve a legitimate function and should not be recognized internationally.

Those who argue that trusts to protect assets against civil judgment

are legitimate, overlook the role civil law plays in controlling fraud. For example, in a recent case the Federal Trade Commission obtained a cease and desist and restitution order against a con-man only to find that his funds were placed in a Cook Islands asset protection trust which is immune from civil claims. The trust has the effect of defeating restitution - an important component of U.S. legal protection against fraud.

Lawyers and accountants who use their professional skills to conceal the ownership of money should be legally responsible if the funds are the proceeds of criminal activities. This principle should apply even if the lawyer is not in the same jurisdiction where the crime was committed.

Credit card information should be available to the government of the countries where the credit card is used no matter what the secrecy law of the government of the issuing institution provide. Banks in secrecy jurisdiction have been offering cards and telling their depositors that they can be used in their home countries with no danger to exposure. This makes the credit card an ideal vehicle for accessing laundered funds.

Free trade zones should be tightly controlled. At one time the zones may have served a legitimate purpose. Today they are for the most part cover for money laundering and smuggling. At the very least, the free trade zones should require that shippers in and out of the zone maintain documentation covering the origin of goods they receive as well as documents covering shipment to the destination. All the transactions and all the documentation should be subject to scrutiny by both the shipping and the receiving country.

Currency remains a serious problem. The wide availability and negotiability of the U.S. dollar makes the job of the launderer much easier. The dollar will shortly be joined by the Euro and the European Central Bank is planning to issue what will be the equivalent of a \$500 bill. This large denomination Euro will be a money launderer's dream. We recommend that the central bank reconsider the \$500 denomination. Further, the periodic recall of all currency would place a serious crimp in the drug trade.

Countries should not charter international banks which are not subject to regulation. A number of countries such as Antigua and now Nevis have been chartering "banks". These banks have concealed ownership and are not subject to serious supervision. Because they are "banks," they can open correspondent accounts with banks in major money centers. As banks they have privileged status. For example, under U.S. law correspondent account funds designated for the benefit of a third party are not subject to seizure. These offshore banks are a perfect gateway for criminals who want to move into the world financial system.

Regulation and supervision cannot be limited to banks if money laundering is to be effectively controlled. In today's financial market, money can be laundered through any company with an encrypted switch. That company can be a brokerage firm, a currency exchange house or a factoring company. In addition, trust companies which

handle corporate matters have to be subject to supervision. If bank accounts are held in the name of IBC's a trust company can move money by merging companies or through adroit shift in corporate names.

Gambling has long been a money launderer's favorite method of hiding cash receipts. The gaming business has globalized and in many parts of the world the ownership and operation of casinos is unsupervised. Substantial international cooperation in the supervision of casinos is indicated.

Two of our suggestions were institutional. The first involved training, the second cooperation. The training level of police who work on financial matters needs substantial improvement. Very few police officers around the world have the financial background and skills to follow an international money trail. Even fewer have the ability to identify fraudulent transactions and recognize the difference between legitimate and criminal transactions. We believe that a training institution should be created at the international level to provide a pool of talent capable of meeting the challenges of policing the global economy.

We also believe that new methods for gather and disseminating intelligence regard financial crime is essential. Until now, major cases have been either sting operations or have involved following and seizing drug money. Systems have to be developed to collate police information from individual cases so that banks and other financial institutions which regularly cooperate with criminals can be identified and targeted. In the BCCI case the GAO found that BCCI had turned up as handling drug funds in more than three hundred cases during the time it operated in the United States. Yet, because the information was never collated, the bank itself was never targeted. This system must be changed.

I believe that the international community is beginning to focus on the scope of the money laundering problem for the first time. It was discussed in a substantial way to the G-8 Summit in Birmingham England and will be subject of a ministerial meeting. Country after country is discovering that, as long as this unregulated offshore network exists, enforcing domestic laws will be very difficult. I believe that the time has come for major changes and that we should take advantage of the moment to coalesce the international community around workable solutions.

¹An International Business Corporation is a corporation with anonymous ownership which cannot do business in its country of incorporation.

Testimony of Jack A. Blum
before
Committee on Banking and Financial Services
House of Representatives
on
Money Laundering and the Movement of Cash from Mexico
May 15, 1997

My name is Jack A. Blum. I am a partner in the law firm of Lobel, Novins & Lamont. I am appearing here this morning at the request of the Chairman and the ranking minority member. This testimony presents my own opinions, based on my knowledge and experience. I am not speaking on behalf of any organization, government agency or private client. The cash smuggling problem on the Mexican border is serious and ongoing. Based on conversations I have had with bankers on both sides of the border, Customs agents, and others who are familiar with the situation, I believe that the estimate that \$30 billion in U.S. currency is smuggled into Mexico each year is too conservative. I believe that most of the currency smuggled into Mexico is related to the narcotics trade, although there are undoubtedly shipments that include the proceeds of other criminal activity.

The smuggling is easy to accomplish because, of necessity, the focus of Customs inspections is on incoming shipments. Their priority is stopping the flow of drugs. But, even if there were intensified inspection of outbound shipments, the flow of currency could not be stopped. The sheer volume of traffic and the variety of ways in which the money can be hidden makes border searches a highly inefficient way of solving the problem. Making matters worse, we are facing an increasing problem of corruption among our own law enforcement personnel working the border.

The money is moving to Mexico because it can be converted in Mexico from currency into a bank entry or a bank draft without triggering reports and investigations. If the funds were deposited in the United States, the deposits would be subject to the CTR reporting requirements and would draw immediate attention. In Mexico, although reporting laws have just been passed, enforcement is nonexistent, and corruption is rampant.

Criminals undoubtedly deposit some of the smuggled currency directly in Mexican banks. The incentives for the Mexican banks to accept cash are enormous. The banks enhance their reserves and make significant profits on the fees they charge for handling and exchanging the currency. However, most of the currency, is being moved through businesses controlled by the money launderers. These include exchange houses and other cash based retail establishments along the border. The businesses then deposit the funds in Mexican banks, which are not in a position to question the deposits.

Many of these border businesses have been purchased by the drug cartels for the purpose of laundering money. When the drug dealers buy into a business they destroy their honest competitors. The drug dealers are not concerned about the profitability of the business. Their business decisions are not market driven. One Mexican businessman I talked to complained bitterly that he would have to sell out because he could not match his drug dealing competitor's investments in new plant and equipment. "They make no business sense," he said. "I don't mind competing with someone who must deal in the same market I do, under the same rules, but these people do not."

The Mexican banking system is a world class basket case. Last week's Wall Street Journal carried an article on the banking crisis in the developing world. In a chart which accompanied the story, Mexico headed the list of countries with major banks in bad shape. I have attached a copy of the story to my testimony for your convenience. I believe that, if the assets of the Mexican banks were marked to market, virtually every bank in Mexico would be insolvent. The problem goes back to the Peso devaluation at the beginning of the Zedillo administration when interest rates rose to more than 100% which put most loans in Mexico into default. Loans to businesses went into default. Mortgage loans and consumer loans which carry floating rates became impossibly expensive for borrowers. Obviously most Mexicans could not make payments.

In response to this crisis, the banks did not foreclose, evict the occupants or sell the houses. The bankers understood that taking such actions would destroy the bank as well as the borrowers. The houses had no market value because there was no financing for prospective buyers. A sale would produce a fraction of the loan value. The day the first house changed hands at the deflated price would be the day the Mexican banking system went down. The Mexican

banks are still carrying billions of dollars of debt on their books at face value, praying for the day when the value is restored, or the government bails them out, or a foreign buyer comes in with a capital infusion.

The key to commercial survival in a situation like this is increased cash flow. Large deposits of currency allow a bank to meet its reserve requirements and its customers' daily business demands.

Just as the Mexicans have said that the drug trade is the result of the demand created by U.S. addicts, we can say that the money laundering business is a product of the hunger Mexican banks have for cash and fee generating business. You may be sure that the fees charged for handling the cash and moving the funds on deposit are substantial. The United States has a strong interest in keeping the Mexican banking system afloat. If it fails and Mexico faces yet another financial crisis, we will face another bailout. Our interest in preserving the banking system in Mexico is in direct conflict with our interest in controlling money laundering across the border.

The cash surplus at the San Antonio Federal Reserve Branch represents a small fraction of the smuggled currency. It is a symptom of the larger problem. It is like a low grade fever that warns the doctor to look for an underlying pathology. A more accurate symptom of the problem would be the total value of Mexican bank drafts transmitted to the United States. Although we have known about the problem since 1992, only recently has the Treasury Department finally amended its regulations to define a Mexican bank draft as an instrument subject to reporting requirements.

The cash that is deposited in Mexican banks goes in many different directions. Some of it is sent to the central bank for repatriation. Some of it is shipped to other banks in other parts of the world which need U.S. currency. And some of it is shipped to correspondent banks in the United States which then turn the cash over to the Fed.

Countries with drug problems are notoriously sensitive about large cash surpluses. In the early 1980's, when Panama was the money laundering capital of the drug world, Panama began to show multibillion dollar cash surpluses. The surpluses defied legitimate explanation. At the time the country had a balance of payments deficit, a balance of trade deficit and a substantial government deficit as well. The United States confronted Panama and demanded action.

A witness at the Senate Foreign Relations subcommittee hearing on drug trafficking and money laundering told the subcommittee that, in response to U.S. complaints, the Panamanian Bankers Association stopped turning the large amounts of surplus cash in to the central bank. Instead, they began a regular weekly charter flight which carried the surplus currency to Switzerland. There, Swiss banks, which specialize in handling foreign currency distributed the money. To the extent the funds showed on the books, it was coming from Switzerland.

The point is that, in the modern world of seamless transportation and communication, there are many options for disposing of surplus currency and attempts to regulate the currency on this side of the border can be avoided with ease. The connection between the drug trade and the survival of the Mexican banks is but a further symptom of the degree to which Mexico has fallen into the grip of organized crime. The last two years of Mexican history have read like an implausible Mario Puzzo *Godfather* novel. The traffickers have been connected to government officials at high and low levels and connections have been established between the billionaire "dinosaurs" of the PRI - Mexico's ruling political party - and the traffickers, as well. The question the United States government has to face is whether the connections between the underworld and the "overworld" in Mexico have reached critical mass.

The dimensions of the corruption are slowly coming into view. The brother of former president Carlos Salinas, Raul Salinas, is in jail in Mexico awaiting trial. More than \$100 million of his money has been seized by the Swiss government as the possible proceeds of drug transactions. Raul Salinas's money moved through the private banking department of Citibank. Raul Salinas was introduced to Citibank's private banking department by Carlos Hank Rhon, the son of Carlos Hank Gonzalez. The Hank family is one of the wealthiest and most powerful in Mexico and was especially close to the Salinas administration. The family has an interest in one American bank and has applications pending to buy another.

The Hermes industrial group, which Carlos Hank Rhon heads, is involved in a variety of business deals including joint ventures with major American corporations. The Hank family is represented in the United States by prominent lawyers and lobbyists.

At the moment there are ongoing investigations of Citibank's private banking operations, the Hank family's connection to money laundering activities, and their relationship to the drug kingpin, Garcia Abrego. But, friends of mine in law enforcement have suggested to me that information is not routinely shared by the agencies involved in the different cases, the regulatory agencies and the intelligence services.

Given the sorry history of United States intervention in Mexico and the howls of nationalism the mere hint of American pressure evokes, our options are limited. The sheer volume of trade between the two countries makes economic sanctions unrealistic. If economic pressure were successful, the principal victims would be American investors, American companies that sell and manufacture in Mexico, and the poorest of Mexicans. For the moment, all we can do is let the criminal investigations proceed. At the same time we must encourage the development of real democracy and real political opposition in Mexico.

It should be said that there are a number of courageous Mexican politicians who have focused on the corruption and have risked their lives to force the issue. Our best hope is that they succeed.

In the long run, to solve the money laundering problem, Congress will have to address the issue of the global use of United States currency. The Treasury sees the use of American currency around the world as a good business. Of some \$400 billion dollars in currency in circulation, only \$100 billion is in use in this country. Each year roughly \$250 billion worth of commercial transactions in the United States are done in cash. The vast majority of those transactions are for less than two dollars. Moreover, the amount of cash in use in this country is declining steadily as electronic alternatives develop.

The Treasury estimates that it earns \$16 billion a year on the \$300 billion in currency offshore because it does not have to pay interest on the outstanding cash. Its only cost is the six cents it costs to print the banknotes.

To protect this profit the Federal Reserve has run ads on foreign television to assure people that U.S. money will never be recalled. Anti-counterfeiting measures were delayed for years because Treasury feared that the introduction of new bills would frighten people into depositing the money in a bank.

This \$300 billion offshore float provides a store of value for a wide range of illicit purposes, including the drug trade. Because the demand for U.S. currency is so great in some parts of the world, especially the former Soviet Union, banks that deal in currency generated in a drug transaction can be sure of a ready market for the cash.

The most effective thing we can do to control money laundering is to get out of the currency business. We should not be providing a store of value for criminals around the world. I would begin the process by pressuring countries such as Panama and Liberia, which use the U.S. dollar as their currency, to give up the practice.

I am not suggesting that we discourage the use of dollars in international commerce. That legitimate business involves bank wire transfers and settlements of close to two trillion dollars a day. Against this volume of serious commerce, the currency business pales into insignificance.

A further benefit of curbing the foreign use of American currency would be to bring some rationality into our relationship with countries that are in desperate need of development funds. When U.S. currency circulates in a foreign country, we are borrowing money from that country. The impact is quite the reverse of stated public policy. Thus, while Congress debates whether to lend Russia a few billion dollars through the world bank at the prevailing interest rates, we have borrowed roughly \$40 billion from the Russians by meeting their almost insatiable demand for greenbacks.

In the short run, I would require reporting by all banks that receive interbank shipments of cash and bank drafts from Mexico. I would also ask the American banks that accept the cash to increase their due diligence to assure themselves of its legitimacy. We should know by now that, just because money comes from a bank, it is not necessarily legitimate.

In addition, the reports along the border need to be on line and the law enforcement agencies need the capacity to respond very rapidly. Several bankers who work along the Mexican border told me that, by the time the suspicious transaction reports and the CTR's reach the authorities, they are historical documents of little use because the people who have delivered the financial instrument and the money itself disappear within hours.

Finally, this committee should focus on the problems law enforcement agencies face in the money laundering area. Money laundering cases are complex. They take time to investigate and are difficult to prosecute. If currency is seized crossing the border as part of the investigation of a drug ring, the case is a slam dunk and, because the agencies involved can recover substantial sums of money, they inevitably invest the effort to make the case.

On the other hand, cases that involve financial institutions, front businesses and powerful individuals are difficult and require lots of time and money. U.S. Attorneys hate the cases because they are complicated and will be well defended by highly paid, competent lawyers who can usually out gun the prosecutors and argue that what happened was just another business deal. Given these problems, the Department of Justice's decision to eliminate its money laundering section is inexplicable.

Senior law enforcement managers must push the system to overcome these barriers. They must encourage the agents on the street to take these cases on and must be willing to invest the time and money to make them. They should visit the border areas for more than a few hours and take a more hands on approach as the cases take form. This Committee must lead the way by telling the law enforcement community that it will not have its budget cut if its numbers fall. Money laundering cases do not lead to good productivity numbers.

This Committee must also use its influence to make the different agencies of government which deal with the problem work together. Again and again, money laundering cases have been the subject of interagency rivalries and disputes. I strongly recommend the book *Washed in Gold*, by Ann Woolner to any of you who doubt what I say. The book follows the investigation of one of the most important money laundering cases ever made. The punch line is that the case was made in spite of the inter agency fighting and the failures of cooperation.

The imbalance in the American response to Colombia as compared to the response to Mexico is striking. My friends in law enforcement tell me that there is strong evidence that some PRI leaders systematically solicited contributions from drug traffickers. The evidence of links between traffickers and commercial enterprises is substantial. In the case of Colombia we have put hundreds of companies on the untouchable list and have decertified the country. In the case of Mexico we have taken a pass. No Mexican assets have been seized and no Mexican companies have been put on the list.

Finally, I would like to defend the certification process. The process has come under attack on many sides over the last few weeks. The leaders President Clinton met with all complained about it, and former President Carter has been talking about making it a multilateral process. In fact the reason the governments are complaining is that it works. In each case the certification process has forced our government and the governments of producing and transit countries to act against some of the worst offenders and to focus attention on a problem that everyone would rather ignore.